

MINUTES

**MONTANA SENATE
56th LEGISLATURE - REGULAR SESSION**

COMMITTEE ON TAXATION

Call to Order: By **CHAIRMAN GERRY DEVLIN**, on April 8, 1999 at 8:00 A.M., in Room 413/415 Capitol.

ROLL CALL

Members Present:

Sen. Gerry Devlin, Chairman (R)
Sen. Bob DePratu, Vice Chairman (R)
Sen. John C. Bohlinger (R)
Sen. Dorothy Eck (D)
Sen. E. P. "Pete" Ekegren (R)
Sen. Jon Ellingson (D)
Sen. Alvin Ellis Jr. (R)
Sen. Bill Glaser (R)
Sen. Barry "Spook" Stang (D)

Members Excused: None

Members Absent: None

Staff Present: Sandy Barnes, Committee Secretary
Lee Heiman, Legislative Branch

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed.

Committee Business Summary:

Hearing(s) & Date(s) Posted: HB 513, 3/29/1999; HB 638,
3/29/1999; HB 651, 3/29/1999;
HB 652, 3/29/1999; HB 669,
3/29/1999
Executive Action: HB 513; HB 632; HB 386; HB
654; HB 569

HEARING ON HB 638

Sponsor: REPRESENTATIVE ROGER SOMERVILLE, HD 78, KALISPELL

Proponents: Ben Haberman, Semitool, Inc.

Aidan Myhre, Semitool, Inc.
Chris Gallus, Montana Chamber of Commerce

Opponents: None

Opening Statement by Sponsor:

REP. ROGER SOMERVILLE, HD 78, Kalispell, said the purpose of **HB 638** is to provide Montana corporations or businesses who are conducting research in Montana with a 5% tax credit for any increases in qualified research activities. He distributed an information sheet, **EXHIBIT(tas76a01)**, and a fact sheet on **HB 638, EXHIBIT(tas76a02)**, which specified the differences of this legislation from the federal legislation after which **HB 638** is modeled.

Proponents' Testimony:

Ben Haberman, Tax Manager, Semitool, Inc., Kalispell, said his company manufactures equipment used to manufacture integrated circuits. All of their production and product development facilities are located in Kalispell; they employ 650 people, 101 of which are engineers and scientists. He said his company relies heavily on their research and development, and without that they would not stay in business. He said no overhead expenses qualify for the credit under **HB 638**, only direct expenses for research and development. The company that qualifies for this credit has to be at risk for those costs, and those research and development costs must increase in order to qualify. He said the businesses listed on the blue sheet, Exhibit 1, are companies which have taken the credit on the federal level. He said **HB 638** is a good bill and would be good for Montana.

Aidan Myhre, Semitool, Inc., presented a letter from Vern D. Child, Vice President, Finance, and Treasurer, RIBI ImmunoChem Research, Inc., Hamilton, in support of **HB 638, EXHIBIT(tas76a03)**.

Chris Gallus, Montana Chamber of Commerce, said this bill encourages Montana corporations to involve themselves more in research and development. It encourages new and innovative product development, and encourages businesses to invest in research.

Opponents' Testimony: None

Questions from Committee Members and Responses:

SEN. BOHLINGER said line 11 of the bill says that the credit can be applied against taxes that will be due. He said that often start-up companies have no earnings for a while, and he wondered if this credit could be refunded. **REP. SOMERVILLE** said there is no refund involved, but the credit can be applied back two years and carried forward for ten years.

CHAIRMAN DEVLIN asked what the reason was for the 12-year life on this bill, and **REP. SOMERVILLE** said it was the feeling that it needed time to work, so that was the reason for taking it back two years and carrying it forward for ten years. **CHAIRMAN DEVLIN** asked if there was any discussion in the House about that, and **REP. SOMERVILLE** said there was not.

SEN. EKEGREN said the bill says, on page 1, line 27, 15 years, and **Mr. Haberman** had said 10 years. He wondered about the discrepancy. **Mr. Haberman** said that 15 years was correct.

SEN. ECK asked if there was a deduction presently for research and development, and **Brian Smith, Department of Revenue**, said there are two tax incentives under current law which apply to research and development, one dealing with property tax on equipment, and one dealing with research and development expenses. **SEN. ECK** asked if this bill would allow some companies to get double credits. **Mr. Smith** said the Department would check.

SEN. ELLINGSON asked what a qualifying research and development expense would be under federal legislation. **Mr. Haberman** said that the IRS has four tests for research activity a company must meet: 1) there must be some uncertainty when a project is started, 2) it has to be technological in nature, 3) it must be a process in experimentation, and 4) it must be for a permitted purpose. **SEN. ELLINGSON** said that overhead is not a qualifying expense, and **Mr. Haberman** said that was correct. **SEN. ELLINGSON** then asked about **Mr. Haberman's** internal bookkeeping and how he separates this category. **Mr. Haberman** said that on external financial statements, these expenses are lumped into one line; but on internal financial statements the lines are broken out and those are analyzed for qualification.

Mr. Smith said he now had the answers requested earlier by **SEN. ECK**. He said presently there are two research and development incentives. One deals with income tax, where any research and development firm is exempt from taxation for the first five years

of activity. There is a potential for a double benefit under current law and this proposed legislation, but those companies would not be taxed anyway. There is also a class five property tax break at 3% of taxable value.

SEN. ELLINGSON said an established business can deduct all of their expenses, including research and development, and **Mr. Smith** said that was correct. **SEN. ELLINGSON** said, then, that if this is passed, they could take their qualifying research and development expenses and take a 5% credit on those in addition to the expense deduction. **Brenda Gilmer, Department of Revenue**, said that was correct.

SEN. BOHLINGER asked what percent of sales are typically budgeted for research and development, and what that amount would be for high tech companies like Semitool. **Mr. Haberman** said that Semitool budgets 15% to 20% for research and development, total, and not all of that qualifies for a credit. He said that in the last fiscal year, they had \$190 million in sales, and approximately \$25 million to \$30 million was spent in research and development. He said that less than half of that qualifies for the the R&D expense on the federal return. He said only about \$4 million qualified for the credit.

SEN. BOHLINGER asked if he could name some other companies that might benefit by this legislation, and **Mr. Haberman** said that technically any manufacturing-type concern or any type of industry that has a new type of product that they have put on the market and is in development would qualify.

CHAIRMAN DEVLIN asked if the Department could provide a list of the incentives and credits offered by Montana, and **Mr. Smith** said they would.

SEN. EKEGREN asked if the figure on the Fiscal Note could possibly mushroom. **REP. SOMERVILLE** said that when the Fiscal Note was initially done for this bill, the figures were derived by looking at the federal tax returns for 1997 and noting who applied for those credits. They then took one-quarter of that, which gave the \$105,000 per year. In talking with Semitool, they have done more research in 1998 than in 1997, so they will actually qualify for more research credit in 1998. **REP. SOMERVILLE** said he had talked to the Department about possibly increasing this Fiscal Note, but they could not do that without hard figures to work with. **Mr. Smith, Department of Revenue**, said the Department had consulted a report from the Joint Committee on Taxation of the U.S. Congress, and in 1997 \$1.2 million had been claimed, and Montana's figures were allocated from that.

Closing by Sponsor:

REP. SOMERVILLE said this bill is trying to promote and enhance economic development for Montana. This will allow Montana companies to obtain credit to conduct even more research in Montana, to expand and create more jobs and additional sales for the state. Research and development is a good, clean industry, and that is what we want in Montana.

HEARING ON HB 513

Sponsor: REPRESENTATIVE JOHN E. WITT, HD 89, CARTER

Proponents: Jane Jelinski, Montana Association of Counties

Opponents: None

Opening Statement by Sponsor:

REP. JOHN E. WITT, HD 89, Carter, said that **HB 513** is a bill that tightens up 15-6-201 of the Montana Code. He said that in November, his county became aware that the Department of Revenue had exempted a large farm in their area which is owned by a church from real and personal property tax. He said the County was providing services in that area, and they felt that they should have at least known this was happening, and they had not been notified. **HB 513** is a negotiation between the County and the Department of Revenue. Page 4 of the bill, item 10, covers what the bill does. "Agricultural property owned by a purely public charity is not exempt if the agricultural property is used by the charity to produce unrelated business taxable income as that term is defined in Section 512 of the Internal Revenue Code, 26 U.S.C. 512. A public charity claiming an exemption for agricultural property shall file annually with the Department a copy of its federal tax return reporting any unrelated business taxable income received by the charity during the tax year, together with a statement indicating whether the exempt property was used to generate any unrelated business taxable income."

Proponents' Testimony:

Jane Jelinski, Montana Association of Counties, said MACo supports **HB 513** because it closes a tax loophole and protects the counties' tax base. She urged support.

Opponents' Testimony: None

Questions from Committee Members and Responses:

SEN. ELLINGSON said that if a church owns agricultural land and is operating it as a farm or ranch and sending all of the produce off to market as any farmer or rancher would do, that is the kind of use of that property that with this bill would no longer be exempt. **Gene Walborn, Department of Revenue**, said that if that produce was taken to market and sold, it would be income and would be taxed. **SEN. ELLINGSON** said, then, that it would have to be reported and taxes paid as if it were a for-profit organization, and **Mr. Walborn** said that was correct.

SEN. BOHLINGER asked who the taxpayers were that would be affected by this legislation, and **Mr. Walborn** said as the bill is written, it is pretty narrowly defined. It has to be an agricultural property owner. He said to his knowledge there is only one situation that would be covered by this bill, and that is the LDS Church farm outside Geraldine.

SEN. ECK asked if property owned by churches and nonprofit organizations have to pay taxes on their agricultural operations, and **Mr. Walborn** said that they do. He said, for example, on the Hutterites, the only property that would exempt would be the church, parsonage or a school. The rest is taxed. **SEN. ECK** asked, then, why this particular property was exempt. **Mr. Walborn** said in this situation the church gives away all the grain. He said they do sell some of their grain, but they replace the old grain with new grain, and their commodity is all given away. If they should sell the commodity and give the money away, that would not be exempt.

SEN. BOHLINGER asked the value of the commodities given away. **Mr. Walborn** said that he did not know because the coordination of giving away the commodity is done through Utah, and this proposed legislation is just for property tax purposes.

Closing by Sponsor:

REP. WITT said that the fact that no one really knows what is actually going on out there is the problem, and this bill makes it possible to know that. He said this is a good bill, and he asked for support.

HEARING ON HB 651

Sponsor: REPRESENTATIVE MARIAN W. HANSON, HD 1, ASHLAND

Proponents: Joe Shevlin, Montana Society of CPAs
Tom Harrison, Montana Society of CPAs

Opponents: Jeff Miller, Department of Revenue

Opening Statement by Sponsor:

REP. MARIAN HANSON, HD 1, Ashland, said **HB 651** changes the way net operation loss figures are determined. She provided a handout entitled "Example," **EXHIBIT(tas76a04)**, and an explanation of **HB 651, EXHIBIT(tas76a05)**.

Proponents' Testimony:

Joe Shevlin, Montana Society of CPAs, said that the CPAs urge support for **HB 651**. He said this bill does one thing: It changes the starting point of the computation of the net operating loss for Montana purposes. He explained that under federal statutes, a business that has a loss can compute a net operating loss, and that can be carried back or forward to offset income. Montana net operating loss computation begins presently at the federal adjusted gross income starting point. He said there is a difference between federal adjusted gross income and Montana adjusted gross income, and those differences are laid out in MCA 15-30-111.

Mr. Shevlin said Montana's interpretation of the net operating loss computation before January of 1992 started with Montana adjusted gross income. At that time, the starting point was changed to federal adjusted gross income. However, the Department of Revenue had the taxpayer add back the items that increased Montana income, but items that reduced Montana income were not allowed in the computation of net operating loss. He said in effect this taxes the taxpayer who has a net operating loss on nontaxable income.

Mr. Shevlin said this is an item of fairness. Taxpayers who suffer net operating losses should not be penalized because they have nontaxable income. This bill restores the Montana net operating loss computation to what it was before January 1, 1992.

Mr. Shevlin said that the Fiscal Note reflects an unknown impact. He said only taxpayers who suffer losses are impacted by this bill, and who also have items that are adjusted out in 15-30-111. It does not affect all taxpayers who have losses, because many of those taxpayers do not have those adjustments.

Tom Harrison, Montana Society of CPAs, said he is not an accountant, so he does not know the technicalities of this issue, but from a lay standpoint, he feels the present interpretation is incorrect and unfair. He said the net result of the

interpretation presently is that it deprives people of the benefit of things that are nontaxable.

Opponents' Testimony:

Jeff Miller, Department of Revenue, said the Department opposes **HB 651**. He said, first of all, a net operating loss is a deviation from our annualized system of taxation in that it allows a business that incurs an operating loss in one year to reduce liability in either a previous year or into the future. That net operating loss serves to offset income that otherwise would be taxed. If this proposal were adopted, it would permit taxpayers to carry back items of deduction that were not even in law in previous years. It also has the effect of causing what is intended to be a business loss to be adjusted or modified by essentially personal items. He said the Department believes these adjustments are incorrect and inconsistent with the purpose of a net operating loss, and therefore oppose this legislation.

Questions from Committee Members and Responses:

SEN. GLASER asked, assuming this bill should pass, what the Department would advise, and **Mr. Miller** said that the Department could conceptually agree with the CPA position relative to items of income that are above the line adjustments to the extent that those are not taxed to begin with. However, to the extent that there is an adjustment that is not part of this, the Department is concerned that this will have the effect of doubling that deduction. It is considered in the current year as well, then, as an adjustment to the net operating loss and therefore has the effect of multiplying it. He would suggest that should this bill pass, the Department and the CPAs work together on possible amendments to correct that issue.

SEN. GLASER referred to the Fiscal Note, noting that the revenue loss is unknown, and he wondered if **Mr. Miller** could expand on that. **Mr. Miller** said he could not.

CHAIRMAN DEVLIN asked what the legislation was he referenced from a special session, and **Mr. Miller** said there was a special session that changed the calculations on nonresidents. He said he believed it was in July 1991. **CHAIRMAN DEVLIN** asked if he could provide that information to the committee, and **Mr. Miller** said he would.

SEN. ELLIS said that medical savings accounts are another way to pay for health insurance, and he asked if there was a problem with any health insurance deduction that ends up in a net operating loss, and **Mr. Miller** said medical insurance is an

itemized deduction and is not subject to any kind of limitation. He said the Department believes that medical savings account exclusions as an addition to the NOL is in effect doubling up on that deduction.

SEN. ELLIS asked what percentage of returns have net operating losses on them, and what percentage of those are affected by this legislation. **Mr. Harrison** said he did not have that information, and did not know if it was available, but a business has to have a combination of a net operating loss and then one or more of those items that are listed; therefore, it is not a great number. He said this is really an issue of fairness.

CHAIRMAN DEVLIN asked **REP. HANSON** if the Department had approached her with any amendments, and **REP. HANSON** said they had not. **CHAIRMAN DEVLIN** asked why the Department did not come with the amendments previously. **Mr. Miller** said the Department has a proposal as to how this could be handled within the Department, and so there are no amendments prepared as of today.

SEN. ELLINGSON asked if this bill would make the computation of net operating loss in Montana consistent with federal statutes. **Mr. Shevlin** said this bill does not change the computation of adjusted gross income. **SEN. ELLINGSON** asked, then, for purposes of computing what a net operating loss is, whether Montana is doing it the same way the federal government is doing it, and if not, what is the policy reason behind the differences. **Mr. Shevlin** said that except for the starting point, Montana will be doing it exactly the same way as the federal does. Presently, because there is a different starting point, there are a couple adjustments that need to be made. This simplifies the computation of a net operating loss.

SEN. ELLINGSON asked what the difference is in starting points. **Mr. Shevlin** said the difference is that at the federal level it starts with all taxable income and then they do the computation. Montana starts with federal adjusted gross income, and under this bill, you would start with Montana adjusted gross income.

SEN. ELLINGSON asked about the Department of Revenue's concerns regarding doubling deductions on some of the permissible exempt items of income if this bill passes. **Mr. Shevlin** said he disagreed with the Department of Revenue. He said there is no double deduction. A business gets a deduction one time, and that is in the difference in the adjustments that are made between federal adjusted gross income and Montana adjusted gross income. Everyone gets that deduction. Montana net operating loss does not allow a business, under this bill, to deduct it again.

SEN. ELLINGSON referred to Exhibit 5, and asked if someone has a net operating loss and currently has income that is in one of these eleven categories, and assuming it was \$5,000, the income from these exempt categories would offset entirely the net operating loss and they would not have anything to carry forward or back. He asked if that was the status of the current law.

Mr. Shevlin said that net operating computations, assuming the net operating loss of \$5,000, if that is a federal net operating loss, then assuming interest income of \$1,000, that interest has offset the federal NOL. Under this bill, under that assumption, Montana NOL would be \$6,000 because that \$1,000 of interest is not taxed under Montana law and therefore should not be used to decrease the loss. **SEN. ELLINGSON** asked if that was under this bill or current law, and **Mr. Shevlin** said under **HB 651** that would be the case. Under current law, the NOL for Montana purposes would be \$5,000.

SEN. STANG asked if both the Department and the CPAs could bring examples of their interpretation of how this is applied on some Montana taxpayers using two or three different methods with some of the eleven categories so the committee could see where the differences arise. They both said they could do that.

SEN. ELLIS asked if it was the eleven items that the Department mostly has problems with, and **Mr. Miller** said that was correct.

SEN. ELLIS asked, then, if it is also true that these are deductible or exempt for income tax purposes, and **Mr. Miller** said that was correct. **SEN. ELLIS** said, then, if a taxpayer does not have sufficient income to cover those in the current year, the taxpayer loses that deduction by not being able to carry it forward or back, and **Mr. Miller** said that was correct.

Mr. Miller said that one of the essential difficulties is perhaps the way the Department reads the mechanics of this bill as opposed to the way the CPAs read the mechanics of this bill. He said he really does read this to say that a taxpayer starts with an amount and then makes an additional add-back for the things that were adjusted to get to that amount. **CHAIRMAN DEVLIN** suggested that the Department and the CPAs work these differences out pretty soon, because time is running out.

Closing by Sponsor:

REP. HANSON said she hopes the opposing sides can work out their differences, because she believes it is a taxpayer friendly issue and a fairness issue, and she urged passage. She asked if **SEN. DEPRATU** would carry the bill.

EXECUTIVE ACTION ON HB 513

Motion/Vote: SEN. EKEGREN MOVED THAT HB 513 DO PASS.

Discussion:

SEN. BOHLINGER said he was considering what is the greater good. He said this is one county that is losing tax revenues, but he wondered about the value of all this wheat that is being given away, whether it is millions of dollars' worth. He said he would place a greater value on the works of charity that they do than on the lost taxes.

CHAIRMAN DEVLIN said there is the consideration, though, of other taxpayers in the county who are picking up those lost revenues.

SEN. ELLINGSON said he viewed the bill as being focused on those kinds of agricultural activities that were not charitable. If this organization were using its agricultural property solely for charitable purposes and giving all of the produce away, it would clearly qualify as exempt. He said he understood the situation is that some of the production is simply going out to market and competing with other agricultural units in the county and in the state. If it were going strictly for charitable purposes, he would strongly stand in support of continuing its tax exempt status, but if it is being used simply as a side business, they should be taxed on that basis.

SEN. EKEGREN said he agrees with that, but the problem arises when these big farms and ranches dictate the property taxes. He said oftentimes these organizations are using these for the purpose of making themselves bigger and stronger. He said he sees it as a matter of fairness, and that these properties should be treated the same as the properties around them. He said he believes this bill is a good starting point, and that these situations need to be looked at. **SEN. EKEGREN** said his question is why should the rest of the county pick up the losses created by the tax exemption of this charitable organization.

CHAIRMAN DEVLIN said that property tax is being exempted because of the gifting of the commodity. He said he didn't feel this was quite right.

SEN. DEPRATU said the bill is probably okay the way it is written. He expected that they would probably be found to be mostly exempt because it is in fact given away. He said the problem arises because their charity is worldwide, and because there is not a catastrophe in Chouteau County, it does not get the benefit of the contribution but it suffers the loss of the

property tax revenue. He said he recognizes that it is not quite fair for the local property owners to have to pick up the loss of revenue there, but the way this bill is written, it probably won't change the amount of tax received.

Vote: Motion carried 7-1 with Bohlinger voting no. SEN. EKEGREN will carry.

HEARING ON HB 652

Sponsor: REPRESENTATIVE MARY ANNE GUGGENHEIM, HD 55, HELENA

Proponents: David Johnson, Montana Society of CPAs
Tom Harrison, Montana Society of CPAs

Opponents: None

Opening Statement by Sponsor:

REP. MARY ANNE GUGGENHEIM, HD 55, Helena, said this bill was suggested by the CPAs who had been working with income taxes for senior citizens who were eligible for the homeowners tax credit. She said the qualifications there, in addition to a taxpayer's age, had to do with total gross income, which has to be less than \$35,000. She said there were situations where, if a taxpayer had in that year cashed in a CD, for instance, what was being contributed to their gross income was that entire amount, rather than just the gain. She said the entire point of the bill is contained on page 2, line 17, which clarifies the definition of income.

Proponents' Testimony:

David Johnson, Montana Society of CPAs, said the Society of CPAs believes there needs to be a technical correction in the matter of fairness and equity. It is also the understanding of the Society that **SB 424** parallels this bill but has less general language as far as the exclusion but also has an increase in the level of income for which an individual could obtain the credit.

Tom Harrison, Montana Society of CPAs, said that the genesis of these four bills that are for technical corrections was a study group of CPAs and the Department of Revenue that has been working on these bills since early last summer.

Opponents' Testimony: None

Questions from Committee Members and Responses:

CHAIRMAN DEVLIN asked if a person had \$10,000 and turned that over every year, eventually he could get taxed out of the whole works under the present law, and **Mr. Johnson** said he would pay the tax on the income and the income on that investment counts toward the income for the credit. Theoretically, you pay tax on the basis of the original \$10,000 invested, and that is taxed already. **CHAIRMAN DEVLIN** said, though, if that \$10,000 was rolled over every year, a taxpayer could get taxed on the \$11,000 every year. **SEN. STANG** said that is not quite correct because it is considered as part of a taxpayer's income to determine the credit, but he is not taxed on the \$10,000, only the \$1,000. What is happening is that that \$10,000 is included as income toward the credit, so it is an eligibility issue.

SEN. ELLIS asked **Mr. Johnson** if he had seen the language in **SB 424**, and he said he had. **SEN. ELLIS** asked which bill was most appropriate, and **Mr. Johnson** said the Society feels that the language in **HB 652** is more broad and more concise with respect to the items that should be called income. **SEN. ELLIS** asked, then, if this amendment should be made to that bill rather than the other way around, and **Mr. Johnson** said that was the Society's position.

Closing by Sponsor:

REP. GUGGENHEIM had no closing statement. She asked **SEN. BOHLINGER** to carry it.

EXECUTIVE ACTION ON HB 652

SEN. STANG asked **Mr. Heiman** if there was any conflict with **SB 424** on **HB 652**. **Mr. Heiman** said there is a conflict. He suggested that this bill be coordinated with **SB 424** so the two could really work well together. **CHAIRMAN DEVLIN** asked **Mr. Heiman** if that could be done, and he said he could do that.

Motion/Vote: **SEN. GLASER** MOVED PROPOSED AMENDMENT TO **HB 652** COORDINATING WITH **SB 424**. Motion carried 8-0.

Motion/Vote: **SEN. GLASER** MOVED THAT **HB 652** BE CONCURRED IN AS AMENDED. Motion carried 8-0.

HEARING ON HB 669

Sponsor: REPRESENTATIVE ROBERT R. STORY JR., HD 24, PARK CITY

Proponents: Stan Kaleczyc, Burlington Northern/Santa Fe
Alec Vincent, Burlington Northern/Santa Fe
Dennis Burr, Montana Taxpayers Association

Opponents: None

Informational Testimony: Mary Bryson, Director, Department of Revenue

Opening Statement by Sponsor:

REP. BOB STORY, HD 24, Park City, said that HB 669 puts into statute the methodology for valuing railroad properties. He said in the past, regarding centrally assessed property, the statutes basically say "the Department will assess the value of the property." That makes it very difficult for centrally assessed companies to plan because they have no concept of what their value and tax requirements are going to be. This bill brings a formula that will be used on railroad property to determine what the assessed value will be. It should put some predictability into the system not only for the railroads but also for the taxing jurisdictions that depend on those properties for a part of their budget.

Proponents' Testimony:

Stan Kaleczyc, Burlington Northern/Santa Fe, said in 1976 Congress passed the 4Rs Act. That statute has a provision in it that says railroads are to be taxed like all other commercial and industrial properties. However, it did not become effective until 1979, so the states had three years to implement the federal legislation. Ever since 1979, each year the railroad has protested its property taxes. Two years ago the railroad and the Department of Revenue agreed on a methodology that they would use on an experimental basis to measure the change in value of railroad property from year to year. That formula that was agreed to at that time looks to more objective criteria and reduces the potential for disagreement on the valuation of the railroad property. HB 669 is a codification of that methodology that has been in place for the last two years.

Mr. Kaleczyc said this methodology has important benefits to all parties. The process is a more objective method and decreases the likelihood of lawsuits and disagreements and protests. It is a more predictable indicator of taxes from year to year, and provides more stability to the taxing system. This is a benefit not only to the taxpayer, but also the Department of Revenue and local governments.

Alec Vincent, Director of Taxes, Burlington Northern/Santa Fe Railroad Company, said he is here from Chicago to ask this committee to support **HB 669**. He said there are three different change factors in this bill: 1) an income change factor, 2) a gross profit margin change factor, and 3) an investment change factor. This bill looks at the year-to-year changes and the objective values of those factors to determine how much overall change should be applied to the base year value.

Mr. Vincent said this formula is a more effective, predictable way to determine what the railroad's liability would be going forward. This has worked well for two years on an experimental basis, and it was decided to codify the method. That is what this bill does.

Mr. Vincent said the three variables are income, gross profit margin and investment. The values for these variables are taken out of published documents that are filed with federal regulatory agencies and also with the state as part of the railroad's property tax return. Those numbers are then plugged into this formula and the number falls out at the bottom. There are no subjective variables involved, and the railroad lives by the number, up or down.

Dennis Burr, Montana Taxpayers Association, said his organization is in favor of **HB 669**. He said his main interest in this bill is the stability in dealing with railroads and other centrally assessed properties. He said these are probably the largest investors in the state of Montana. The way the property tax is presently structured, these entities have the least ability to predict what their taxes are going to be in ongoing years. He urged support for this proposed legislation.

Opponents' Testimony: None

Informational Testimony:

Mary Bryson, Director, Department of Revenue, said that **HB 669** provides stability for both governments and taxpayers and predictability regarding the tax base and taxes paid. However, on the other side of that, after the base value is established, it cannot be changed. Base values may not reflect market value. It does provide that predictability, but it also makes for some inflexibility to the process we have in place today and to the assessed values. The formula is fairly rigid and fairly inflexible. It is slow to recognize change, which does provide stability, but does not recognize potential justified increases or potential justified decreases as quickly as can be done today, and it does provide one industry special treatment under current

law. Property that is in the same class will have different appraisal methods if the formula is adopted because this is consideration of railroad property only and not other properties that are also in class twelve, and there is little or no growth that could occur.

Questions from Committee Members and Responses:

SEN. ELLINGSON asked if someone from the Department could describe or define the formula. **Gene Walborn, Department of Revenue**, distributed an example of the railroad formula calculation worksheet, **EXHIBIT (tas76a06)**. He said the first part is the actual determination of how the Montana market value is determined. The middle section on the first page is the formula itself and the three change factors that are addressed in the bill. The last part of the first page is the detailed information used to arrive at those change factors. Page 2 shows the property change factor information, and the last part is the allocation information that the Department uses.

SEN. ELLINGSON asked if there were three variables, the income of an entity, the gross profit margin, because that goes up and down, and a property factor, which would be additions to property within the state of Montana or systemwide. **Mr. Walborn** said the property factor is specific to Burlington Northern/Santa Fe's system throughout the United States. He said these three change factors are shown in the middle of the first page. He said this example is incorrect in that it does not reflect depreciation, and it shows a single year, while the formula is actually set up on a two-year allocation average.

CHAIRMAN DEVLIN asked if historically there are negotiations after the tax bill is sent and usually a reduction in those taxes follows that negotiation. **Mr. Walborn** said typically there has been a settlement of one type or another. **CHAIRMAN DEVLIN** asked if the taxes were ever raised through those negotiations, and **Mr. Walborn** said in his experience that had not been done.

SEN. DEPRATU said the Fiscal Note shows a \$100,000 hit, and on line 1, it talks about an anticipated growth of 2%. He said there had been testimony that there has been growth in the last two years, and he wondered if that was about accurate as to that growth. **Pat Keim, Burlington Northern/Santa Fe**, said the growth rate over the past two years has been more in the area of 10%. **Mr. Walborn** said that 2% figure comes from **HB 2**, which says that centrally assessed companies will grow at the rate of 2% per year.

SEN. BOHLINGER asked if the Fiscal Note were recalculated with the information that has been made available concerning the growth within the company, would the hit to the General Fund go away. **Mr. Walborn** said that that potential could be there. As **Ms. Bryson** said earlier, from 1990 assessments to 1998, the system value went up on the top part of the change factor, but the allocation percentage went down. He said he cannot predict what that allocation factor might do, although adding the two-year allocation will help that level out. **SEN. BOHLINGER** said that the railroad investments in Montana are higher than any other state, and he wondered why this Montana allocation factor is so low. **Mr. Walborn** said this worksheet is just an example, it is not for Burlington Northern/Santa Fe. He said Burlington Northern/Santa Fe is around 7%. Montana has about 7%. He pointed out that the second page of the example shows how the allocation factor works.

CHAIRMAN DEVLIN asked whether the company would no longer protest their taxes if this bill is passed, and **Mr. Vincent** said that based on this bill, he would not anticipate having a valuation-type case, which was the reason for the disputes referred to. He said there is a similar formula in place in the state of Arizona. **Mr. Vincent** said they had had eight years of federal litigation in Arizona, and at the end of that time, there was an agreement to put this type of formula into place. That took place in 1992, and from that time forward, the railroad files a three-page return and that is what they pay. There have been no disputes in Arizona since 1992. **CHAIRMAN DEVLIN** asked, though, if without this legislation they would definitely dispute their taxes. **Mr. Vincent** that they would have no choice but to dispute them.

SEN. GLASER asked if the state is no longer arbitrating with the railroad over the annual tax bill, would the Department be saving some staff time. **Mr. Walborn** said that centrally assessed property is valued annually in a three-month period, and the staff works overtime to do that. He said this may reduce that somewhat, but it will not reduce staff time overall.

SEN. DEPRATU asked if this formula had been used for the last two years and whether it had worked, and **Mr. Walborn** said it has been used for two years, but it is a year-to-year agreement; however, the formula was used to arrive at a final tax, and it has worked.

SEN. ECK said at one time it was suggested that railroads should be valued at scrap value, and she wondered if that might still be true. **Mr. Walborn** said that refers to a summation appraisal, and sometimes those are higher and sometimes they are lower.

SEN. BOHLINGER said in the formula presented, 50% of the value is based on an income change factor and 25% of the value is based on a gross profit margin factor, and 25% on the property factor based on original cost. He asked if this methodology is used universally amongst railroads, or is this particular to Montana. **Mr. Walborn** said this formula is used in one other state, Arizona. **SEN. BOHLINGER** asked **Mr. Vincent** if Arizona's formula is weighted in the same manner as in this proposed legislation, and **Mr. Vincent** said it is basically the same weighting and same formula in Arizona. He said the variables that are used in this formula are also used in all other states to determine the value of all centrally assessed taxpayers.

SEN. STANG asked if all the technical notes have been addressed, and **Mr. Walborn** said the first one does not require a change, the second one has been addressed, the third one is somewhat addressed in that the Department can handle this through administrative rules, and the fourth one has not been addressed but could probably also be addressed through administrative authority. **SEN. STANG** asked, then, whether **REP. STORY** would be comfortable with the Department having administrative authority or if that definition should be made statutory as to the definition agreed upon by the Department and the railroad. **REP. STORY** said the purpose of the bill is to get as much laid out in the statutes as possible, but he did not have a problem with it either way.

SEN. STANG then asked **Mr. Vincent** if the railroad and the Department could provide a definition of operating revenues that has been agreed upon, and **Mr. Vincent** said they could probably do that. He said the definition that is being used comes right out of the report that the railroad files with the Service Transportation Board, and there has never been a dispute as far as the definition of operating revenues. **SEN. STANG** asked if an amendment could be requested in that regard, and **CHAIRMAN DEVLIN** asked the railroad and the Department to provide that amendment.

SEN. ELLIS asked how long the dispute usually takes when the taxes are paid in protest and therefore are not available to the taxing jurisdictions, and **Mr. Kaleczyc** said in recent years the protests have been resolved in a fairly timely way so that there has been no large-scale disruption. Historically, however, in the 1980s, the federal court litigation generally was lasting somewhere around three years. **SEN. ELLIS** said if this legislation is a resolution of this problem that is mutually acceptable, why does the Fiscal Note show slowly increasing fiscal long-range impacts. **Mr. Walborn** said the Department has some concerns about formulas and for what taxpayer, but the graph

that shows an escalating negative revenue is the way the impact is calculated.

SEN. ELLINGSON said he is concerned about the first two factors. He asked if the income change factor is not a factor that reflects the gross income but reflects actual earnings. **Mr.**

Vincent said this would be earnings before interest, depreciation and taxes, and the same factor is employed in both of those calculations. **SEN. ELLINGSON** said his concern is what the impact would be on taxable value and therefore tax revenue if the railroad industry had a sustained decline or depression so that over a five-year period there were no earnings. He wondered if the top two factors would be zero, and railroad property in the state would only be valued on factor No. 3, which is only 25% of the total weighting factor. **Mr. Vincent** said he did not think that would happen because the earnings definition is not net earnings. He said it would be very difficult to have a zero value there. He said the concern about the downside trend is a valid one, and that is why the five-year averages were used, to moderate the increases and decreases.

SEN. ELLINGSON asked when interest, taxes, depreciation and lease rental expenses are added back into the earnings, what percentage of the gross revenue is being talked about. **Mr. Vincent** answered that it was 25%.

SEN. ELLINGSON referred to the last few questions of **Mr. Vincent**, and he asked **Mr. Walborn** if the Department was comfortable with those factors. **Mr. Walborn** said the five-year average helps to mitigate some of the swings. He said there could potentially be a problem with prolonged tailspins, but he felt that would be addressed with the five-year average.

SEN. DEPRATU said if Montana did not have this bill and simply continued as they have been, would the state still be in a negotiating position which would reflect that decline if the railroads should experience such a decline. **Mr. Walborn** said that would be the case with any industry, and hopefully the market value would reflect the economic realities of what is happening in that company.

Closing by Sponsor:

REP. STORY said that in the House there were two bills dealing with centrally assessed properties, one which dealt with every centrally assessed property out there, and then this railroad bill. He said the hearing in the House was actually on the other bill. When the hearing on this bill came up, because it had all been discussed in the other bill, the committee just shot this

one through. However, the other bill died because there were some problems, so the railroads were left in this bill. Because of that, he said he appreciated the thorough hearing on **HB 669**. He said he feels that the bill has some merit to it, and he hoped the committee would give it serious consideration.

CHAIRMAN DEVLIN asked who would carry this bill on the Senate floor, and **REP. STORY** asked if **SEN. DEPRATU** would carry it.

EXECUTIVE ACTION ON HB 386

SEN. ECK said there were many things about this bill she liked, especially the way it was mandated; however, it seems that somewhere decisions have to be made as to how many of these tax cuts we have, and they should be looked at and prioritized.

SEN. GLASER said he has looked at some of these bills and has prioritized them. He said he is going to go with **SB 184, SB 200** and **SB 260**.

SEN. ELLIS said he agreed with **SEN. GLASER**, with one exception. He said that while he endorses an income tax reduction, this is actually a credit for property tax, not the kind of income tax reduction that would result in economic incentives for Montana. As a result, he is not going to support this one.

Motion/Vote: **SEN. GLASER MOVED THAT HB 386 BE TABLED. Motion carried 7-2 with DePratu and Stang voting no.**

EXECUTIVE ACTION ON HB 654

SEN. ELLINGSON said **REP. SCHMIDT** had asked him to carry this bill, but he is not the accounting whiz that **SEN. STANG** is, and he felt that **SEN. STANG'S** concerns are well taken. However, he has also expressed the opinion that those concerns could be addressed if this were given a couple of years to work its way into the system. With that background, **SEN. ELLINGSON** felt the effective date should be a year or so out so that people can plan for this. That will deal with the concerns expressed and the one-time positive impact on the General Fund, which he is not comfortable with.

SEN. STANG said he did not have a problem with the concept of the bill. He said it suddenly requires that deductions be done on an accrual basis where they have been on a cash basis, so there is an inconsistency there. However, if the committee thinks this is a good idea, then he believed that **SEN. ELLINGSON** is right, it needs to be effective January 1, 2002, and should apply to tax years after December 31, 2000. That gives people a couple years

to plan. He said if there were amendments to that effect, he would support the bill; otherwise, he would not.

SEN. GLASER suggested that on page 4, line 12, the effective date be changed to January 1, 2002, so it applies to years beginning December 31, 2001. He felt that would be the correct amendment to give people a chance to get the process phased in.

Motion/Vote: **SEN. GLASER MOVED AN AMENDMENT TO CHANGE THE EFFECTIVE DATE TO JANUARY 1, 2002, AND APPLIES TO TAX YEARS AFTER DECEMBER 31, 2001. Motion carried 8-1 with Devlin voting no.**

Motion: **SEN. ELLINGSON MOVED HB 654 DO PASS AS AMENDED.**

Discussion:

SEN. DEVLIN said that even with the delayed date, he did not feel this should be done.

SEN. DEPRATU said he voted for the amendment because he felt it helps the bill in case it does pass, but overall he is very uncomfortable with the bill and will not support it.

Vote: **Motion failed 3-6 with Devlin, Bohlinger, Ekegren, Ellis, Glaser and Depratu voting no. (Roll call vote No. 1)**

Motion/Vote: **SEN. DEPRATU MOVED THAT HB 654 BE TABLED. Motion carried 6-3 with Eck, Ellingson and Stang voting no. (Roll call vote No. 2)**

EXECUTIVE ACTION ON HB 569

Motion: **SEN. ELLINGSON MOVED HB056903.ALH, **EXHIBIT**(tas76a07).**

Discussion:

SEN. ELLINGSON said the amendments provide that the expenses for transportation are deductible not only to corporations but to any business. He said the way it was drafted and presented to this committee, the deductions were only available to corporations. Secondly, he was concerned with the fact that any of the deductions are presently available to taxpayers, so he is proposing an amendment that would make it a tax credit rather than a deduction, with it set at 15%.

SEN. ELLIS said the amendment does make the bill somewhat tolerable. He agreed with **SEN. ELLINGSON** that these expenses are deductible already, and the bill as written would limit the

ability of companies to take these deductions. He said he will support the amendment, but he will not support the bill.

SEN. BOHLINGER said it is his understanding that it really is a benefit if it increases the number of riders on the bus system because it then allows these systems to apply for federal grants. He said anything that can be done to help these people provide this public service should be moved forward.

Vote: Motion carried 9-0.

SEN. ELLINGSON said there has been concern in the committee about whether local governments are making a contribution. He said in Missoula the City makes a substantial contribution to alternate transportation through the Mountain Line Bus System. He said he did not feel it was legitimate to ask whether state revenue should be used to help specific localities and infer from that that these entities are not making a contribution. They are already making a contribution, and he feels that the state should join with them in a partnership to make a statewide contribution.

CHAIRMAN DEVLIN said he has some amendments to put some responsibility on the local governments. **Mr. Heiman** provided copies of HB056902.alh, **EXHIBIT(tas76a08)**.

Motion: SEN. DEPRATU MOVED HB056902.ALH.

Discussion:

CHAIRMAN DEVLIN said these amendments require the local governments to pay at least 50% of the cost of qualifying transportation alternatives. **Mr. Heiman** said he missed the 50% in the title, but that would be corrected, and **CHAIRMAN DEVLIN** said that would be changed as part of the amendment to 50%. He said he felt that there should be a substantial amount of participation, more than what is being done presently. He said this is a whole new program, and they should help support this as much as the state.

SEN. ECK asked if the contributions to this program are all federal funds through the Department of Transportation. She said presently the Department is having a hard time finding matches for those funds so that they can be used. She said she thought local governments might be eligible for that. She said if this had to come from local General Fund monies, it would be impossible for the local governments to participate, but perhaps these funds could come from these federal funds.

CHAIRMAN DEVLIN said the purpose of the bill is for conservation and carpooling and mass transit and alternative methods of transportation.

SEN. GLASER asked if this amendment was requiring taxpayers in these particular locations to contribute to this program, and **CHAIRMAN DEVLIN** said that was the intention of the amendments.

SEN. ELLINGSON asked, then, if an individual business buys transit passes for their employees, they will not be able to get a credit on their taxes unless the locality has also paid 50% of the costs of those transit passes. **CHAIRMAN DEVLIN** said that was correct. **SEN. ELLINGSON** said he understood where **CHAIRMAN DEVLIN** was going from a philosophical point of view, but he opposed the amendments because he would want to have a chance to think through the implications before voting for it.

Vote: Motion carried 5-4 with Bohlinger, Eck, Ellingson and Stang voting no. (Roll call vote No. 3)

Motion/Vote: **SEN. ELLINGSON MOVED THAT HB 569 BE CONCURRED IN AS AMENDED.** Motion failed 4-5 with Devlin, Ekegren, Ellis, Glaser and DePratu voting no. (Roll call vote No. 4)

Motion/Vote: **SEN. ELLIS MOVED THAT HB 569 BE TABLED.** Motion carried 5-4 with Bohlinger, Eck, Ellingson and Stang voting no. (Roll call vote No. 5)

ADJOURNMENT

Adjournment: 11:15 A.M.

SEN. GERRY DEVLIN, Chairman

SANDY BARNES, Secretary

GD/SB

EXHIBIT (tas76aad)